

SOME PROBLEMS OF FOREIGN EXCHANGE CONTROL
IN ARGENTINA

BY

JAY WILSON WILEY

A. B., Lawrence College, 1935

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AN ABSTRACT OF A THESIS

SUBMITTED IN PARTIAL FULFILLMENT OF THE REQUIREMENTS
FOR THE DEGREE OF DOCTOR OF PHILOSOPHY IN ECONOMICS
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SOME PROBLEMS OF FOREIGN EXCHANGE CONTROL IN ARGENTINA

A. Resume of exchange control development in Argentina.

Argentina adopted foreign exchange control in 1931, at a time when many nations of the world were introducing similar devices for controlling their balances of payments through import and export controls. The initial program was simple in concept. Exporters were required to turn over to the banks and exchange dealers in Argentina all foreign exchange derived from the sale of exported products. The government, in turn, assigned the available foreign exchange according to its concept of the essentiality of the uses to which foreign exchange would be put: first, for services of government debt and other governmental expenditures abroad; second, for imports of raw materials, fuel, and indispensable consumers' goods; third, for current private financial services and other private remittances; fourth, for non-essential merchandise; and, finally, for redemption of old commercial debt.

During the period preceding the introduction of exchange control, the peso had been depreciated by about 39 per cent from its 1929 gold value. The rate at which it was stabilized by exchange control was an overvalued one, in terms of the current balances of payments and the internal price level, in that imports were made for which no foreign exchange was available, resulting in the accumulation of blocked peso balances owed to foreigners, in the development of an active black market in which the peso was quoted at an additional discount of 40 per cent over the official exchange rate, and in the development of pressure from countries which were important markets for Argentine exports to be given preferential treatment of imports. It is difficult to determine to what extent depression in Argentina's principal export industries, agricultural and pastoral, was a result of the

overvalued exchange rate under the initial exchange control program inasmuch as agriculture was in a generally depressed condition throughout the world at the time.

In November, 1933, the simple and rigid exchange control program was abolished and a new system put into operation. Under the latter system, regular (grain and meat) exports could be made only by offering the resulting foreign bills of exchange to the official market at a fixed rate. For a time, a system of appraisals of the values of these exports was used as a device for assuring the collection of the requisite foreign exchange. The foreign exchange acquired in this manner was offered to importers with prior exchange permits at rates above the buying rate. The margin between the official buying and selling rates was used by the government to pay part of the debt service and to support subsidies to agriculture. Foreign exchange derived from non-regular exports, from shipments to adjoining countries, and from all other foreign transactions entered the free market, a market supported but not controlled absolutely by the government. Rates of foreign exchange in the free market were substantially higher (less favorable to importers) than the official market selling rate. The intended effect was to induce importers to apply for permits to acquire foreign exchange in the official market. In granting such permits, the government was able to discriminate in favor of a) desirable imports and other payments, and b) favored countries of origin. In order to make this discrimination more effective, between April 13, 1935, and January 28, 1938, a period of relatively abundant foreign exchange, a tax was levied against imports effected with free market exchange, amounting to a figure sufficient to keep the total cost of imports made through the free market 20 per cent higher than for imports paid for with exchange bought at the official market selling price.

In November, 1938, as foreign exchange became more scarce during the depressed period of world trade immedi-

ately preceding the outbreak of war in Europe, Argentina required prior permits for imports effected *via* either the official or free markets. Quotas were assigned for imports according to article, country of origin, and rate of exchange (official rate or free market rate, later changed to preferred official rate and official rate). In the early part of the war, a variety of special exchange rates were devised, and eventually, in 1941, the quota and prior permit system was abandoned in favor of multiple rates of exchange, also assigned to imports according to article and country of origin.

During the war, the exchange surplus, in blocked currencies, gold, and dollars, reached great proportions. Nevertheless, in November, 1946, the prior exchange permit system, with assigned quotas, was reintroduced, and the number of exchange rates at which the payment for imports could be effected was reduced to three.

During the period of exchange control, certain exports were granted favorable exchange treatment that amounted to an exchange subsidy. These were the non-regular exports, for which the resultant foreign exchange was not negotiated at the official buying rate but at a higher rate more favorable to the exporters. In 1933, the non-regular exports amounted to about two per cent of all exports and by 1943 they amounted to 40 per cent of all exports, a result of the favorable exchange rate, the increased diversification of Argentine industry, and the market conditions of the war period. After 1943, many categories of goods were shifted from the non-regular to the regular export list so that in 1945 only about 9.5 per cent of exports were given the preferential exchange treatment.

The foreign exchange control system outlined above was examined with the purpose of analyzing, empirically and theoretically, four problems, as follows:

1. The effectiveness of foreign exchange control as a device for protecting domestic industries, and the national

direct loss that would be involved in such protection.

2. The manner in which exchange control becomes complementary to bilateral trading devices, including assignment of foreign exchange to various countries in accordance with the payments received from those specific countries rather than permitting multilateral settlement of trade.

3. The tendency for exchange control, whatever be the reason for which it is originally introduced by a country, to become only one step in a program of national economic planning leading toward *autarchy*.

4. The relationship of foreign exchange control to exchange rate equilibrium, with some examination of the possible alternatives to exchange control as well as the difficulties a nation would face in maintaining, via exchange control, other than an equilibrium rate of exchange.

B. Cost of foreign exchange control in terms of trade.

With respect to the first point listed above, the effectiveness and cost of foreign exchange control as a protective device, the conclusions reached varied with the several types of market conditions assumed. Exchange control refers in the following analyses to a rigid rate of exchange, with no appreciation or depreciation of that rate and with a system of exchange quotas for rationing scarce foreign exchange. Graphic presentation was used to indicate the effect of exchange control on the terms of trade through changes in the cost of imported goods. In the general analysis which follows it is assumed that the demand by importers for foreign produced goods is an exact reflection of the demand by consumers, and no adjustments are made for importers' operating costs, changes caused by uncertainty as to future exchange treatment, and other unmeasurable factors. If there were competition among buyers and sellers of goods in general (importers and exporters) and the importing country with exchange control imported a sufficiently large share of the stock of a good to affect the world price, the terms of

trade would improve, as the foreign exporters' selling price fell. Importers, however, would make profits from the spread between the new lower export price and the higher possible selling price in the internal market when a smaller quantity was available to consumers due to the exchange quota system. In order to prevent a maldistribution of income and an increased propensity to import (by wealthy importers' families) from resulting, a government practicing exchange control should take this special profit to itself by means of an exchange auction or importers' license fees designed to absorb the profits. The nation gets fewer imports but gives up still fewer exports for them. It was suggested that a country importing agricultural products (such as the United Kingdom and Germany) would be in this position but that Argentina would not.

If, on the other hand, exporters had a monopoly on the articles, the cost to the importing country would rise if less exchange were made available for importing the articles. Thus the terms of trade would be worsened. This situation is likely to occur for a country importing manufactures, cartelized raw materials, and similar products where there may be some monopolistic influences. Argentina would be such an importer and tend to lose, in inferior terms of trade, by exchange control. In addition, it was pointed out that exchange control may have the effect of bringing about a foreign exporters' monopoly that had not previously existed. This would be the case if bilateralism were a result of exchange control, the smaller the source of supply being, the more likely that monopoly on the part of the suppliers would prevail. Hence the very use of exchange control would make a country's terms of trade inferior and increase the unbalance in its current international accounts.

In still another case, exchange control may have the effect of bringing about monopoly by importers. If exchange permits and licenses are scarce, only a few importers rather than many may bring a good into the country. Under such

a condition, the terms of trade for the country would improve, the monopolistic importers using the full weight of their position to force the foreign price down, but the quantity imported might be very small, with unused surplus exchange permits, as the importers raised the domestic price of the good by means of limitation of supply beyond that brought about by the exchange rationing itself. In this instance, it would be difficult for the government to collect the monopoly profit from the importers by means of the above mentioned auction or license fees as the monopolists could buy from others their permits and licenses and still gain. The effect would be to increase the distortion in income payments and increase the propensity to import luxury goods into the colonial type economy.

In a final case, a single domestic producer may have had his incipient monopoly position limited by foreign competition. With exchange control the absolute limit imposed on imports of the goods he produced would give him the power to raise his prices without fear of renewed competition from abroad. In order to adjust to his most profitable production under monopoly conditions the monopolist may very well contract rather than expand domestic production after the introduction of exchange control. Hence, factors of production would be used at less than full efficiency; idle resources would not be exploited because of the limitations imposed on imports; and, although the terms of foreign trade may be improved for the nation, the over-all position of the people might become inferior to what it was prior to the introduction of exchange control. In Argentina, monopolistic concentration in manufacturing industry is quite pronounced.

It would appear from the above theoretical analysis that a country such as Argentina would lose rather than gain by foreign exchange control. Nevertheless, behind the rigid protective barrier of foreign exchange control, there was a rapid development of manufacturing industry in Argentina.

To the extent that the "infant industry" argument is valid, Argentina may gain in the long run from the forced expansion of local manufacturing, temporary uneconomic utilization of resources being offset by increased efficiency later on as size and maturity of industry are attained. In addition, there is some advantage in diversification; the nation will suffer less during the periods when the world markets for her agricultural products are depressed since she will have greater variety of industry and lessened need for imports to maintain consumption.

Figures on the rate of growth of Argentine industry during the 1930's are incomplete and inadequate: nevertheless, they are sufficient to demonstrate that Argentine manufacturing industry expanded at a rate much more rapid than the expansion of manufacturing throughout the rest of the world, and more rapidly than Argentina's imports expanded. An index of manufacturing production in Argentina, based on the census of manufactures, shows an overall expansion in the value of manufacturing between 1935 and 1941 of 85.5 per cent. During the same period the value of imports increased 8.7 per cent, having reached a peak of 32.4 per cent above the 1935 total in 1937 and declined steadily thereafter as world trade became depressed after 1937 and Argentina tightened her exchange restrictions. During the war period after 1941 Argentine manufacturing expanded rapidly as foreign sources of supply were temporarily shut off.

C. Exchange control and bilateralism.

Argentina complemented exchange control with bilateral trade agreements soon after the initiation of the program. In 1933, the first payments agreement was negotiated with the United Kingdom. Thereafter, and by the end of 1938, additional payments agreements were concluded with fourteen European countries and a clearing agreement was negotiated with Germany. This form of bilateralism, which controlled payments but did not discriminate by customs tariffs, was

generally assumed to be not contrary to the provisions of "most favored nation" agreements with other countries. The reasons for arranging the agreements showed two sides of the same problem. With countries with which Argentina normally maintained a favorable trade balance, she was forced to negotiate bilateral agreements giving favorable exchange treatment to imports from those countries in order to maintain her markets in those countries. With countries with which Argentina had unfavorable trade balances, the reverse was applied, Argentina requiring that those countries increase their purchases of Argentine products or receive unfavorable exchange treatment on imports from those countries into Argentina.

Although the total trade of Argentina increased during the years 1933 to 1939 as trade improved, her imports from countries with which she had bilateral agreements increased at a slower rate than total imports, that is, the percentage of imports originating in such countries declined. Of countries with which bilateral agreements were concluded between 1933 and 1938, the percentage of Argentina's total imports was in 1933, 61.2% ; 1934, 60.7% ; 1935, 57.4% ; 1936, 58.1% ; 1937, 56.9% ; 1938, 55.7% ; and 1939, 47.4% (58.3% for the first half of 1939). The reason for the tendency for imports from nations with which no such bilateral agreements were in effect to increase more rapidly than total trade apparently lies in the spread of opportunities in free areas with expanding trade as against the limitation of trade with such areas during periods of contracting trade, inasmuch as trade with treaty countries was required to be maintained.

It is difficult to believe, therefore, that bilateralism was responsible for the improvement in Argentina's world trade during that period. On the contrary, bilateralism apparently tended to act against trade expansion. This experience is in accordance with traditional theory, the opportunities for trade between nations on a barter basis being more limited

than the opportunities for multiangular trade. In addition, when it is remembered that bilateral discrimination increases the possibility of monopoly on the part of foreign exporters, with the consequent worsening of the terms of trade for the importing country, there seems to be little economic justification for bilateralism of the sort Argentina practiced during the 1930's. Furthermore, as the trade cycle moved into the recession phase, in 1938 and 1939, Argentina found that her foreign trade was in a strait-jacket. As her foreign exchange reserves became depleted it was necessary to increase very sharply the restrictions on trade with countries with which she did not have bilateral treaties, as a nation cannot recoup its foreign exchange reserves from trade with countries with which it maintains clearing or payments agreements.

During the war, Argentina's bilateral clearing agreements were based largely upon war-time exigencies. The clearing agreement with the United Kingdom, for instance, made it possible for Argentina to supply the British market with agricultural products and receive a large part of the payments in blocked sterling, which was used to reduce Argentina's sterling debt and to purchase the British-owned Argentine railways. Other agreements with Spain, Brazil, Paraguay, Bolivia, and Chile had as their principal motive the search for alternative markets and sources of raw materials during the war period. After the conclusion of the war, clearing agreements were negotiated with the Belgium-Luxembourg Union, France, Sweden, Switzerland, Spain, and others, a feature of which generally involved the granting of a rotating credit by Argentina to those countries in order to finance purchases of Argentine products in the early post-war period.

A tendency toward increased government intervention was evident in the post-war agreements in that Argentina pressed toward customs union with adjoining countries which she considered in her sphere of influence and assisted those countries, and Spain, with developmental loans provided by

the Instituto Argentino de Promocion del Intercambio. The developmental loans were for projects that would benefit Argentina, such as transportation facilities to the Argentine border. The Instituto was also given exclusive control over exports and imports in barter agreements with those and other nations.

D. The tendency for exchange control to lead toward national economic planning of an autarchic nature.

Throughout the world in recent years there has been an increased tendency to concentrate economic power in the hands of the state. It is difficult to demonstrate that foreign exchange control is the cause of such spreading control. In fact, it may be but one facet of it. Nevertheless, it is demonstrable that foreign exchange control gives the state detailed information and power over the economy that facilitates the expansion of national planning. In Argentina, the development of governmental intervention in the economic development of the state in recent years has paralleled the increasing complexity of foreign exchange control.

Argentine foreign exchange control over imports was applied with a view to acquiring desired quantities of needed articles from preferred countries at the official (more favorable) rate of exchange. Originally, there was only one rate, and if exchange were not allocated for the importation of an item that good could still be imported with no guarantee that exchange would eventually be forthcoming. Under the prior merit system, however, if foreign exchange was not assigned in the official market, payment for imports could be made with exchange acquired at a less favorable rate in the free market. For a time, from 1939 to 1941, exchange for non-preferred imports was allocated on a quota basis at a fixed rate of exchange. From 1941 to December, 1946, quotas were not assigned but different imports were paid for at a variety of exchange rates. After December, 1946, quotas were reinstituted for many goods and were assigned to the Instituto Argentino de Promocion del Inter-

cambio, a device to assist the government in prosecuting the development of its five year plan for industrialization.

In all of the above mentioned controls over imports, detailed information was required by the government on the need for imported goods, the selling prices at which those goods could be sold, and the extent to which they could be replaced with domestically produced substitutes. Such knowledge, once acquired, is a major aid to a government intent on state control of all forms of economic life.

With respect to exchange control over exports, the effects of the program as a step towards autarchy are even more pronounced. Since the government allowed certain special products, and "non-regular" exports to be shipped and the resulting exchange to be negotiated at a more favorable rate of exchange than for regular exports it had the means of granting profits or losses to an industry, and to control its rate of development.

Furthermore, the profit made from buying foreign exchange at one rate and selling it to importers at a higher rate was partially used to subsidize desired production. This had two effects. The industries involved were beholden to the government for continued prosperity, and the industries had to form semi-official boards to distribute the subsidies. It was easy to convert this organization of a national industry into government controlled corporations of the fascist type. The form of control involved usually developed from a program under which the government supported prices of a product and sold surpluses in the world market at any price to a program whereby it was required that all of the product destined for export be sold to the government agency which, in turn, as world prices rose, sold the goods in the world market at a higher price. Through the profits made in this fashion, the Argentine government has been able partially to finance its industrial expansion program. Furthermore, it has been able, with some success, to keep domestic prices down during a period of internal monetary inflation resulting

from the Treasury policy of deficit financing.

At present, most agricultural products are sold in world trade only by the Instituto Argentino de Promocion del Intercambio, which has enabled the government to enter into barter agreements, trading scarce food stuffs for desired manufactures and for political favor.

Finally, inasmuch as it has been pointed out above that exchange control tends to lead to monopoly by importers which profit at the expense of the people and the government, a sole government importer can receive all the profits from such a development. Also, as was indicated above, export monopoly tends to improve the terms of trade for the exporting nation. Usually, agricultural exports are not monopolized. However, in Argentina's case, the country is the principal exporter to the markets in which it sells corn, linseed, beef, quebracho, and some other products. A government sponsored or government owned export monopoly improves the nation's terms of trade, offsetting somewhat the inferior terms of trade that may result from exchange control when imported goods are monopolized abroad, since by monopoly higher prices may be charged for a limited volume of sales.

E. Exchange equilibrium and exchange control.

In spite of the above described defects of exchange control, it may be desirable, for a short time, for a nation to use foreign exchange control as a device for bringing artificial equilibrium to its balance of payments. It may be impossible within practicable limits for there to be a rate of exchange at which there would be equilibrium in the balance of payments and with respect to domestic economic activity without exchange control if there were sudden great changes in the size of the nation's international debits and credits. If a readjustment of the national economy is necessary before a new equilibrium can be achieved, a considerable period may elapse before the adjustment is

completed, considering the rigid pattern of the economy and the inflexible nature of economic institutions and the inelasticity of demand for many imported and exported goods. During the period of adjustment, exchange control may be necessary. The control may speed the readjustment if it is fitted to a foreseeable future pattern of trade (such as protection of infant industries), or it may hamper readjustment by preventing necessary changes in prices from taking place.

For Argentina, the period of the early 1930's was one of such major disequilibrium. On the debit side of the international balance sheet, new foreign lending practically ceased after 1928, and the total value of agricultural exports declined by more than one half between 1928 and 1933. The cessation of foreign lending was a result of the world depression. The decline in export values was attributable to falling world prices of agricultural commodities partly induced by protection in normally importing countries, partly induced by decline in consumption in importing countries during the depression, and partly induced by the depreciation of foreign exchange rates, virtually amounting to exchange dumping, by raw material exporting countries, including Argentina. On the credit side, the value of debt service of all kinds remained at the previous level (except for devaluation of the currencies of foreign creditors, such as the devaluation of the pound sterling in 1931), decline of dividend remittances during trade depression being offset by the increased cost of interest payments in foreign monies as the peso depreciated. Imports of merchandise tended to fall more slowly than export values due to the natural lag between falling exports and national propensity to consume and to the inflationary credit policies of the government which had previously practiced deficit financing by foreign loans.

Argentine exports of linseed represented 65 per cent, of corn 50 per cent, of beef 28 per cent, of lamb and mutton 13 per cent, and of wheat 12 per cent of the consumption in

the markets they entered, being sufficient for the Argentine export prices to influence the buying prices in those markets. When Argentina established foreign exchange control, the internal prices of its products improved in comparison to prices received in other agricultural nations. Apparently exchange control not only did not seriously hurt Argentine producers but helped to stop the world wide price decline, as one source of exchange dumping was removed. Furthermore, Argentina's exchange depreciation was partly induced by the price fall of her principal exports which in turn was partly caused by anticipated further depreciation.

Argentine exports were highly inelastic in supply, being agricultural products the volume of which was affected more by the weather than by price. Her imports were inelastic in demand, accounting for roughly 30 per cent of all internal consumption and including raw materials for industry, fuel, and necessary consumers' goods for the semi-colonial economy. Thus price changes did not influence exports or imports greatly, in volume. Only long run changes in industrial development would have that effect. It was concluded that exchange control was a necessary and desirable governmental measure during the emergency period of low agricultural prices.

Later, in 1933, the conditions causing extreme disequilibrium had ameliorated somewhat so that further depreciation of the peso in November of that year was reflected immediately in improved internal prices for agricultural products. It is possible that at this time equilibrium in Argentina's balance of payments could have been restored without exchange control. Nevertheless, the nation chose to develop the flexible two-market system of exchange control, keeping the rate of the peso fixed at the new level for a majority of the international exchange items. The rigidity of the controls imposed in the official market was reflected in the accumulation of a foreign exchange stabilization fund which during the relatively prosperous mid-thirties reached

a maximum of 698.3 millions of paper pesos in value. Virtually all of this fund was used up during the recession of 1937 and 1938. The tendency for this exchange surplus to cause the general price level to rise and through that for the demand for imported commodities to increase was partially offset by the short term fund absorption policy of the Central Bank.

The peso probably would have improved between 1934 and 1936 in the absence of exchange control, since the severe restrictions necessary to maintain the fixed official rate in 1933 and 1934 were gradually relaxed up to 1938. The subsequent decline in Argentina's international economic position in 1937, 1938, and 1939 testifies to the highly cyclical nature of the nation's international economic fortunes and to the wisdom of building up a large stabilization fund, if not of exchange control itself. Certainly exchange control did not insulate Argentina from the effects of the trade cycle or from price level changes elsewhere in the world. In fact, a rigidly fixed rate of exchange tends to translate world price level movements into the domestic economy, through changes in import volume as export values shift.

On the basis of the study of the Argentine exchange rate disequilibrium of the 1930's it is suggested that:

- a) not all balance of payments disequilibria can be solved by varying rates of exchange;
- b) reserves of foreign exchange and gold would have to be enormous to tide a nation through a short but severe disequilibrium in its balance of payments;
- c) real solution of fundamental disequilibrium may involve a significant, and time consuming, change in the structure of a nation's trade;
- d) foreign exchange control, or similar state control over trade, may be necessary during the period of transition;
- e) the programs outlined in the Bretton Woods agree-

ments and the proposed International Trade Organization may reduce the severity of cyclical variations in international trade but will not be sufficient to solve international economic disturbances without new retreat into trade-reducing and discriminatory controls by affected nations if the nature of an economic slump is severe or if rapid shifts in the pattern of trade take place; and

- f) nevertheless, some method of assuring that exchange control be used only temporarily is desirable, in view of the uneconomic nature of the device, and the repercussions of exchange control on other relations between the state and private enterprise.

VITA

Jay Wilson Wiley was born in St. Paul, Minnesota, on August 24, 1913. His elementary education and high school training were received in the public schools of St. Paul and Milwaukee, Wisconsin. He entered the University of Wisconsin, Extension Division in Milwaukee, in February 1931 and attended that school until June 1933. In September 1933 he entered Lawrence College, Appleton, Wisconsin and received the degree of Bachelor of Arts in June 1935 and of Master of Arts in June 1936. In the fall of 1936 he entered the Graduate School of the University of Illinois, pursuing his graduate work there in the years 1936 to 1938, the summers of 1937, 1938, and 1939, the year 1946-1947 and the summer of 1947. He was an Assistant in Economics at the University of Illinois from 1936 to 1938 and in 1946-1947. In the fall of 1938 he accepted a position in the Department of History, Economics, and Government of Purdue University, Lafayette, Indiana. He was granted leave of absence in June 1942 to accept employment in the United States Department of Labor, Bureau of Labor Statistics until December 1942 and the Office of Price Administration from December 1942 to December 1943. He served in the United States Navy from November 1943 to March 1946. When released from military service he returned to Purdue University where he taught until July 1946. He was granted leave of absence from that institution during the year 1946-1947 and returned to Purdue University to resume his teaching in the fall of 1947.

